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SUBJECT: KAZAKHSTAN CLOSES IN ON EITI VALIDATION

REF: ASTANA 0948

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11. (U) Sensitive but unclassified. Not for public Internet.

12. (SBU) SUMMARY: From November 23-December 2, independent validators based in the UK interviewed government officials, non-government organizations, energy executives, and diplomatic representatives to assess Kazakhstan's progress toward validation under the Extractive Industries Transparency Initiative (EITI). The validators said that while Kazakhstan is likely to complete the validation process by the end of 2009, the Ministry of Energy and Mineral Resources (MEMR) and the energy companies involved in the initiative have done little more than meet the bare minimum requirements for validation. They -- and the NGO representatives they spoke with -- are concerned that once validation is achieved, there will be little incentive for Kazakhstan to continue to improve transparency in the extractive industries sector. END SUMMARY.

#### THE BENEFITS OF EITI

13. (U) The Extractive Industries Transparency Initiative (EITI) aims to increase transparency in transactions between governments and companies within extractive industries. Benefits include an improved investment climate by providing a clear signal to investors and international financial institutions that the government is committed to greater transparency. In extractive industries, where investments are capital intensive and dependent on long-term stability to generate returns, increasing transparency and reducing uncertainty is beneficial for business. Increased transparency also benefits civil society by disclosing payments that companies make to governments for energy resources, thereby making governments more accountable to their citizens. Kazakhstan's EITI work plan, including measurable targets, a timetable for implementation, and an assessment of potential capacity constraints, is available at [www.eiti.kz/en/workplan/](http://www.eiti.kz/en/workplan/).

#### THE IMPORTANCE OF VALIDATION

14. (U) Validation is EITI's quality assurance mechanism and serves

two critical functions. First, it promotes dialogue and learning at the country level. Second, it holds all EITI implementing countries to the same global standard. Validation is not an audit. It evaluates EITI implementation in consultation with stakeholders, verifies achievements with reference to the EITI global standard, and identifies opportunities to strengthen the EITI process going forward. The 28 EITI candidate countries, including Kazakhstan, must complete validation by March 2010. If validation is not completed, or if the validation review shows that there has been no meaningful progress toward achieving EITI compliance, the EITI Board will revoke that country's candidate status. Azerbaijan (February 16) and Liberia (October 4) are the only two countries that have successfully completed the EITI validation process to date.

#### VALIDATORS SAY KAZAKHSTAN HAS MADE SIGNIFICANT PROGRESS...

15. (SBU) On December 1, Energy Officer met with Chris Nurse, Director of the Hart Group, an audit and consulting firm based in Oxfordshire, England, and Dmitry Pozhidayev, a social development advisor retained by the Hart Group to assess Kazakhstan's progress toward EITI validation. According to the terms of the EITI, payments and revenues must be reconciled by a credible, independent administrator using international auditing standards, including an opinion on the financial statements and identification of any material weaknesses.

16. (SBU) Overall, according to Nurse, Kazakhstan has made significant progress under EITI and, although a final report will not be available for several weeks, he indicated that Kazakhstan would complete the validation process by the March 2010 deadline. Nurse said that more than 90% of oil and gas revenue in Kazakhstan is disclosed via EITI reports.

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#### BUT MORE WORK REMAINS TO BE DONE

17. (SBU) However, according to the validators, only 60% of the revenue from the mining industry is disclosed according to EITI procedures. Industry leaders, such as Kazakhmys, KazZinc, KazAtomProm, and Arcelor Mittal, have shown little to no interest in the initiative, which Nurse asserted sets a bad example for other mining companies. He added that only 20% of companies in the extractive industries -- and no Chinese businesses -- have signed the EITI memorandum of understanding. (NOTE: Nurse complained that MEMR was unable to produce a comprehensive list of companies operating in the extractive industries sector, and said it admitted it had misplaced the document containing the original signatures of the companies that initially signed up to EITI. END NOTE).

#### QUESTIONS ABOUT KMG'S CASH FLOW AND DUAL ROLE

18. (SBU) The validators expressed concern that the government and energy companies operating in Kazakhstan have not indicated any desire to go beyond the most basic requirements of EITI. In fact, some, such as national oil company KazMunaiGas (KMG), refused to meet with the validators during their visit. Nurse said he wanted to question KMG about its cash flow and contributions to government revenue. He also wondered about the potential conflict of interest in KMG's dual role as both the government's regulatory authority and an equity partner in major projects, such as Tengiz and Kashagan.

#### NGOS SAY VALIDATION IS NOT THE END OF THE PROCESS

19. (SBU) Dmitry Pozhidayev met with several NGOs during his visit to Kazakhstan and expressed a high opinion of their efforts to increase transparency and accountability. Despite their passion and dedication, he asserted they did not fully succeed in speaking with one voice through the coalition that they created to monitor Kazakhstan's EITI progress -- Oil Revenues Under Public Oversight. Pozhidayev said the NGOs are concerned that the government and energy companies will have no further incentive to continue to push for greater transparency once Kazakhstan has achieved validation. "They think they're done!", he exclaimed, "but they need to go further and deeper, to make EITI part of the business culture."

HOW INDEPENDENT ARE KAZAKHSTAN'S NGOS?

¶10. (SBU) On November 25, Energy Officer met with Pavel Lobachev of the Almaty-based NGO "Echo," which is a member of the EITI NGO coalition. A lifelong resident of Almaty, Lobachev has traveled to the United States twice under the International Visitor Leadership Program and provides social marketing research and analysis to private companies, the OSCE, and independent political parties in Kazakhstan. He said he has repeatedly turned down state grants under the Civic Alliance Program, because he said the money comes with strings attached. Lobachev said that once an NGO receives a government grant, it also receives directions from the local government on how and where to spend the funds. Lobachev said he knows of NGOs that were forced to stop core social projects in order to focus on the government's priority. He said that there are at most "two or three" legitimate, independent NGOs in each oblast.

¶11. (SBU) Pozhidayev, however, disagreed. He said there are so many independent, diverse NGOs in the Civic Alliance that the government "cannot possibly" control them all.

¶12. (SBU) COMMENT: Kazakhstan has indeed made demonstrable progress under the EITI, thanks in large part to the efforts of international oil companies (reftel). However, it would be a mistake for those companies or the government to assume that validation is the end of EITI. On the contrary, Kazakhstan must continue to improve transparency in its mining sector, at the local government level, and at National Welfare Fund Samruk-Kazyna if it is to remain an attractive, long-term investment opportunity for strategic investors. END COMMENT.

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